
0500 TERMS AND DEFINITIONS

The following terms are used extensively in all phases of multistate audits, and in many cases the terms are statutorily defined. The field auditor should develop a working knowledge of these terms and definitions.

Abbreviations Used

- **MATM:**
Multistate Audit Technique Manual
- **MAPM:**
Multistate Audit Procedures Manual
- **SBE**
State Board of Equalization

Allocation

Allocation is the assignment of nonbusiness income to a particular state (CCR §25121(a)(3)).

Apportionment

Apportionment is the process by which business income is divided between states by the use of a formula containing apportionment factors (CCR §25121(a)(2), MATM 7000).

Apportionment Formula

An apportionment formula is a formula composed of a property factor, a payroll factor, and a sales or revenue factor. The formula calculates the percentage of business income, which is derived from or attributable to sources within this state (R&TC §25128, MATM 7000).

Business Activity

Business activity refers to transactions and activity occurring in the regular course of a particular trade or business of a taxpayer (CCR §25121(a)(4)).

Business Income

Business income is income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the

acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations (R&TC §25120(a), MATM 4000).

Combined Report

A combined report is a report in which the business income and apportionment factors of a unitary group of corporations are combined for purposes of determining each taxpayer's share of the California unitary business income. On July 13, 1999 the first phase of the combined reporting regulations under R&TC §25106.5 went final. This regulation provides a description of how the combined report is determined. The regulation is retroactive and is applicable to all audits.

Commercial Domicile

The commercial domicile is the principal place from which the trade or business of the taxpayer is directed or managed (R&TC §25120(b), MATM 1500).

Compensation

Compensation includes wages, salaries, commissions, and any other form of remuneration paid to employees for personal services (R&TC §25120(c), MATM 7320).

Doing Business

"Doing business" in a state means actively engaging in any transaction for the purpose of financial gain or pecuniary profit (R&TC §23101).

Fiscalization

Fiscalization is the process of placing the income and formula factors of unitary corporations with differing accounting periods onto a common taxable year-end in order to compute a combined report. The computations necessary to perform the fiscalization are described in MATM 5200.

Foreign Corporation

A foreign corporation is any corporation other than a California corporation.

Formula Factors

The Uniform Division of Income for Tax Purposes Act provides that all business income shall be apportioned to this state by use of property, payroll, and sales factors (R&TC §25128).

1. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used everywhere during the taxable year (R&TC §25129, MATM 7100).
2. The payroll factor is a fraction, the numerator of which is the total amount of compensation paid by the taxpayer in this state during the taxable year, and the denominator of which is the total compensation paid everywhere during the taxable year (R&TC §25132, MATM 7300).
3. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. For taxable years beginning on or after January 1, 1993, the sales factor is double-weighted (R&TC §25134, MATM 7500).

Intrastate Apportionment

Intrastate apportionment is the process of determining the California income apportioned and allocated to each California taxpayer in a combined group. This process is necessary in order to determine the individual tax liability for each taxpayer, as well as to properly compute items such as NOLs, AMT and tax credits. Intrastate apportionment is discussed in MATM 7900.

Multistate Tax Compact, Multistate Tax Commission

The Multistate Tax Compact is an agreement among participating states to facilitate the uniform administration of state taxes for multistate taxpayers. The Compact incorporates UDITPA, and establishes the Multistate Tax Commission (MTC). The MTC is charged with studying state and local tax systems, developing and recommending proposals for improvement and increased uniformity of state and local tax laws, and administering the Multistate Tax Compact. States join the MTC by enacting the Multistate Tax Compact (including the UDITPA provisions). California is a member state.

Nexus

Nexus is the connection with a state which gives the state jurisdiction to impose a tax. See MATM 1100.

Nonbusiness Income

Nonbusiness income is all income other than business income (R&TC §25120(d), MATM 4000).

Public Law 86-272

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Public Law 86-272 (15 USCA 381) was enacted in 1959 to limit the states' ability to tax interstate commerce. It provides that a state cannot impose a net income tax on a business if the only business activities within the state are limited to the solicitation of sales of tangible personal property. (MATM 1200 - MATM 1240)

Sales

Sales means all gross receipts of the taxpayer not allocated under R&TC §25123 through R&TC §25127 as nonbusiness income (R&TC §25120(e), MATM 7510.)

State

State includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof (R&TC §25120(f)).

Taxable In Another State

For purposes of apportionment and allocation of income, the taxpayer is taxable in another state if either of two conditions exist. A taxpayer is taxable in another state if within that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax. A taxpayer is also taxable in another state if that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether the state actually imposes such a tax upon the taxpayer (R&TC §25122).

A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in such other state pertaining to the production of nonbusiness income or business activities relating to another separate trade or business (CCR §25122(a)).

Taxpayer

A taxpayer is any person or bank subject to the tax imposed under Chapter 2 or Chapter 3 of the Bank and Corporation Tax Law (CCR §25121(a)(1); 23037).

Throwback Sales

When sales of tangible personal property are shipped from an office, store, warehouse, factory, or other place of storage in a state where a corporation is taxable to a state where the corporation is not taxable, those sales are assigned to the state from which the goods were shipped (the state of origin).

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(R&TC §25135(b), MATM 7530). Sales subject to this exception to the general rule of assigning sales to the destination state are referred to as throwback sales. If the taxpayer is not taxable in the state from which the property was shipped, the double throwback rule is applicable (see MATM 7532).

Uniform Division Of Income For Tax Purposes Act (UDITPA)

UDITPA was drafted by the National Conference of Commissioners on Uniform State Laws to provide rules for the allocation and apportionment of income of multistate businesses. Once the tax base (eg. net income) has been defined by a state, UDITPA operates to define business and nonbusiness income, to define the apportionment formula which is used to apportion business income, and provides specific rules for the allocation of nonbusiness income.

The model UDITPA sections have been incorporated into the Multistate Tax Compact, which may be found in both the CCH and Prentice Hall editions of the California Income Tax Laws. California adopted UDITPA with some modifications in 1966 with the enactment of R&TC §25120 to R&TC §25139. Some of the deviations that California has made from the model UDITPA are:

- California applies the UDITPA rules to banks, financial corporations and public utilities, although such entities are excluded under the model UDITPA.
- Although California had previously adopted Section 6 of UDITPA dealing with the allocation of capital gains and losses (R&TC §25125), this section was modified in 1988 to provide special rules for allocation of gain or loss from the sale of a partnership interest (MATM 4040).
- In 1993, California departed from the equally weighted three-factor formula used in the model UDITPA by instituting a double-weighted sales factor (R&TC §25128, MATM 7500).

Unitary Method Of Taxation

The unitary method of taxation is not a tax. It is a method by which the business income of a unitary business is divided among the taxing jurisdictions in which it operates. (MATM 3000.)

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